RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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February 25, 1977 **LETTER 690**

Feb. 11, DJIA 931.52; PTI 825; A-D Ratio –19.70
Feb. 18, DJIA 944.73; PTI 827; A-D Ratio –19.74

FOURTH QUARTER PESSIMISTS: It is a basic principle of Dow Theory that the trend, once confirmed, is taken to remain in force until proved otherwise. This principle is of most help in dealing with the primary trend, a bit less help when dealing with the secondary trend, and of least help in identifying the daily or minor trend. Right now Dow's Theory states that the primary trend is bullish. It was confirmed as bullish on January 27, 1975.

It always interests me when secondary lows are established during a bull market (as they were last October and November), and subsequently the news turns increasingly black–but the secondary lows **hold**. The implication, assuming they continue to hold, is that the lows represented the worst that the sharpest eyes (and the strongest money) could foresee in the period ahead. In such instances, the technical condition of the market usually strengthens, and Wall Street prepares for the next major advance.

In the latest issue of *Barron's* (February 21) an article entitled "Heavy Liquidation" tells us that among investment companies "sellers topped buyers five-to-one in the fourth quarter" (and of course this refers to common stocks). Assuming that kind of selling produced the October-November lows in the D-J Averages, it will be interesting to see whether any new spate of selling can produce enough liquidating pressure to smash the fourth quarter lows (924.04 for Industrials and 203.85 for Transports). If those lows do hold (if even one of them holds), the implications will be clear. Smarter money than that which controls the investment companies was accumulating during the fourth quarter. In time, we will have the answer to that one.

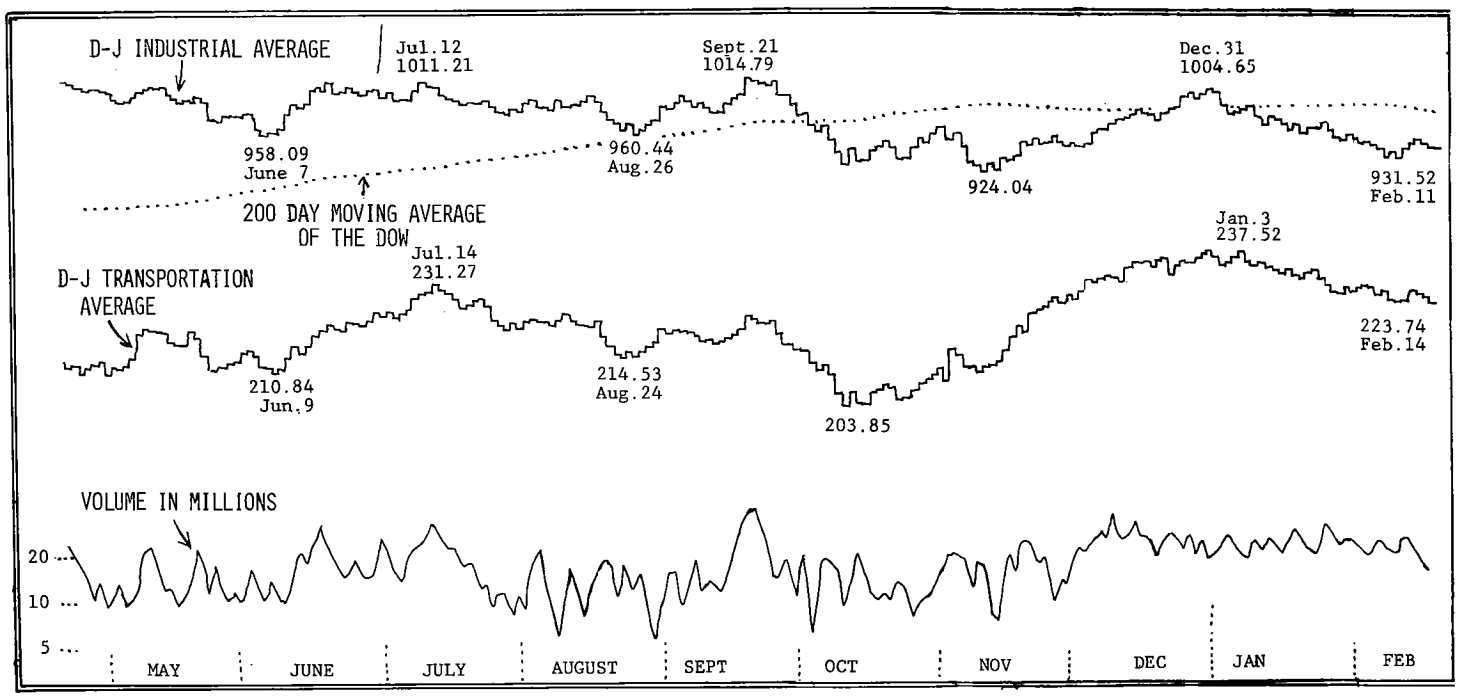
THE PICTURE: The great Russian genius, Dostoievski, wrote a novel entitled *The Idiot*. The central character of this novel was so saintly, yet *simple*, that people called him "the idiot." Yet his goodness and simplicity continually overpowered sophistication and evil, and at one point Dostoievski had the idot tell an unhappy courtesan, "Be simple and rediscover the world."

I have often wished that the same philosophy could untangle the webs of Wall Street (and perhaps it can). The sophistication now being applied to the study of the stock market is literally mind-boggling. Yet among all the indicators and advanced techniques, it is easy to lose the central thread, and this thread is the **great primary trend** or tide of the market.

Market indicators are certainly useful, but they can also be confusing. For instance, it is noted by some that NYSE margin debt is now at historic. highs. The bulls claim that when margins are at a new high it is bullish, since it is characteristic of an ongoing bull market to produce new peaks in debit accounts. The bears claim, however, that the current record level of margin debt is dangerous, that it implies a debt structure that is too high and ready to topple over.

By the same token, specialists' shorts have been subtly climbing since October, and the bears may claim that this trend implies technical deterioration. But I note that the average of specialists' shorts as a ratio of total member shorts has been below 45% for the past 28 weeks, and this constitutes a bullish situation. The current 28 weeks is a longer period than the 19 weeks of "below 45%" in the ratio that accompanied the late-1974 bear market bottom.

I could go on and on with this kind of "dual analysis." But I prefer **simplicity**. And the kind of simplicity I am referring to has to do with my studies of the Averages and the Dow Theory.



When all is said and done, I always stand on my Dow Theory interpretations to guide me. I firmly believe that the Averages contain **all** that **everybody** knows about business, finance, the stock market, and the economy. The Averages are a function of the NYSE debits, the short interest, the odd lots, the price of steel, Carter's domestic policy (if there is one), the price of eggs in Iowa, the effects of the California drought and the odds on Idi Amin living out 1977.

Glancing at the p.1 chart, we can say that the Averages (in January) failed to break out *jointly* above their 1976 highs. True, the Transports did record a new bull market peak of 237.52 on January 3, buf there was a problem–the Industrials failed to confirm. Industrials refused to confirm by failing to better their previous bull market high of 1014.79 (recorded September 21) .

Having failed on the upside, the D-J Averages, since January 3, had a go on the downside. The news since January has been, to put it mildly, conducive to lower prices. A devastating drought in the West, a deep freeze in the East, whopping Government deficits, a big pop in the Consumer Price Index, a fuel shortage, meandering business, interest rates edging up, and a President who claims to be "learning" (even though nobody's sure what he's learning), all these the market has had to contend with.

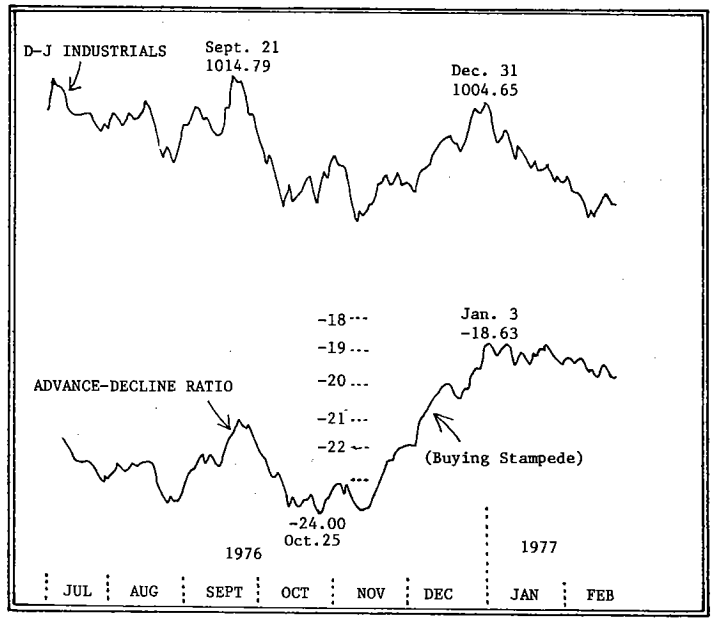
Nevertheless, the situation as it stands at this writing is not totally desperate. With all the gloomy news, the market, so far, has absorbed it rather well. The Industrial Average is *still 16 points above* its 924.04 low of last November. And even more impressive, the Transports are *still 21 points above* their October low of 203.85. As far as I am concerned, the **longer one or both Averages hold** above the Oct-Nov lows, the better the odds are that the Averages **discounted the worst** at those lows (i.e., the October-November lows).

If that turns out to be the case, if the Industrial low of 924.04 and the Transport low of 203.85 represented the points at which the Averages discounted the worst that could be seen ahead–then the next major swing of the market will be up. Again, I will remind subscribers that a penetration of one Average, **unconfirmed** by the other, is usually deceptive and absolutely meaningless for purposes of identifying the trend. Therefore, if Industrials for instance, break below 924.04 without Transports confirming, I would draw no bearish conclusions from such action.

Turning to the shorter-term outlook, the Averages, on February 11, recorded minor lows of **931.52** for Industrials and **223.74** for Transports. A breaking of **both** of those lows on increasing volume would pave the way for a testing of the earlier lows (or at least an Industrial testing of 924.04). However, if we get a penetration of one of those lows with the other Average not confirming, we could have the launching platform for a very good advance.

PRICE–BREADTH: The action of the A-D Ratio over the past week has been about as mysterious and unusual as I've ever seen it. As you can see on the accompanying chart, the A-D ratio rose over 5 points from its October 25 low to its January 3 bull market high. Following a buying stampede, any decline of more than 1 point serves to signal the stampede's ending. But I quoted James Hughes (in the last Letter) to the effect that Hughes always gave minor downside penetrations of the 1 point range the benefit of the doubt before calling for the end of a buying stampede.

As of Friday, February 18, the A-D Ratio had slipped eleven hundredth's below the 1 point range or 1.11 under the January 3



peak. This week the A-D slipped further, just a slight bit further, to 1.17 under the January 3 peak. I can't tell at this time whether we will have to say "farewell" to the buying stampede or not.

The incredible balancing act by the A-D Ratio seems to be just one more symptom of the market's general nervousness and confusion. And it looks again as if I'll have to wait for the "Late Notes" section of this Letter before deciding what the A-D Ratio is saying, and what I'll be saying about the A-D Ratio.

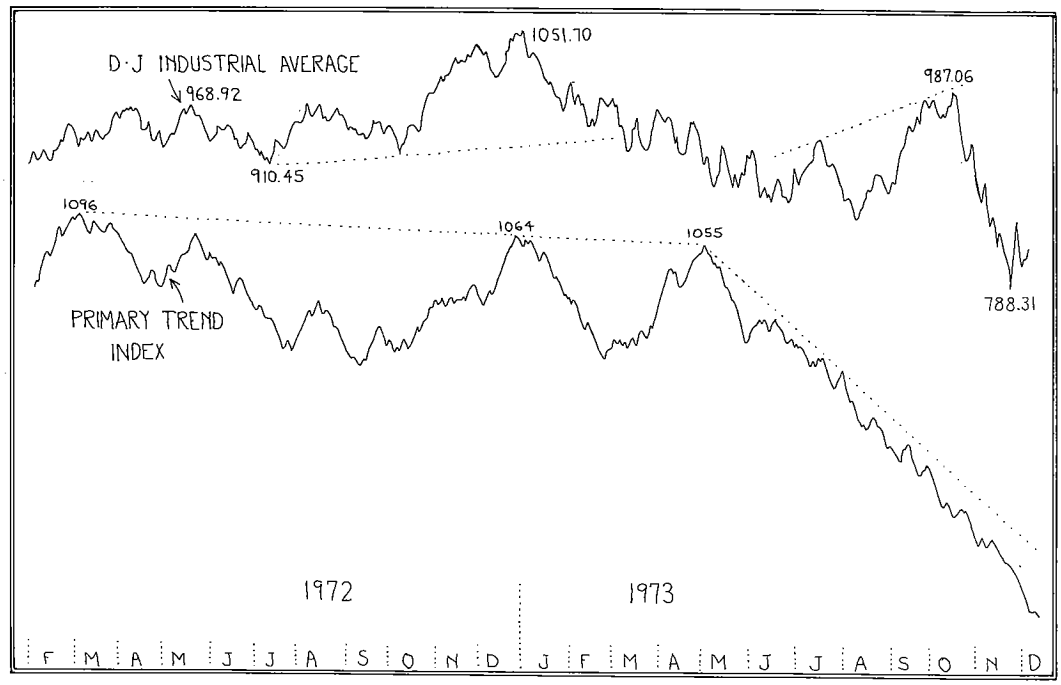
PRIMARY TREND INDEX (PTI): In 1971, during a particularly difficult period in the market, I sought to construct an index which (1) was proprietary, in that only I knew exactly what it was, (2) could be computed on a daily basis, (3) would tend to move with the great primary trend of the market, and (4) was composed of five or more important indices, which, when combined would show the flow of funds–into or out of the market.

After much experimenting and pondering, I came on the theory of my primary trend index, or PTI. This index is based on the action of the three D-J Averages, the S&P 500 Composite, the D-J Bond Average, the daily A-D ratio figures, the daily most-active stock figures and the daily new high and low figures. I used eight components for my PTI. I felt that any one indicator or average could be misleading at times, but that there was little likelihood that the majority of all these critical and widely-followed indices and averages would be wrong over any reasonable length of time.

In other words, I wanted a daily index which would act very much like a bathtub. If the primary trend was bullish, then the waterline of the bathtub would slowly rise, the tub would tend to fill up (regardless of splashes and ripples). Conversely, if the primary trend was bearish the PTI should act as if someone had pulled the bath stopper. In that case, regardless of activity in the bathtub, the water would relentlessly run out.

I was studying the PTI last weekend from its inception in late 1971 to date. And I couldn't help noting the dramatic difference in the Dow-PTI action during the *primary bear market period* of 1972-73 and the *primary bull market period* since 1974. I have included two charts. The first covers the 1972-73 action of the Dow and the PTI. This bear market chart is worth studying carefully.

From the April, 1971 peak of 968.92, the Dow advanced to a January, 1973 record high of 1051.70. But the PTI refused to confirm, failing by 32 points (at its January, 1973 peak) to better its early 1972 high. Following the January, 1973 non-confirmation, the Dow and the PTI plunged to lower levels. In February a surprising rally took place in the over-sold PTI, carrying it to an April peak of 1055 (all while the Dow slipped lower). But again the PTI retained its pattern of lower peaks. The April PTI peak was 9 points under the December, 1972 peak of 1064.

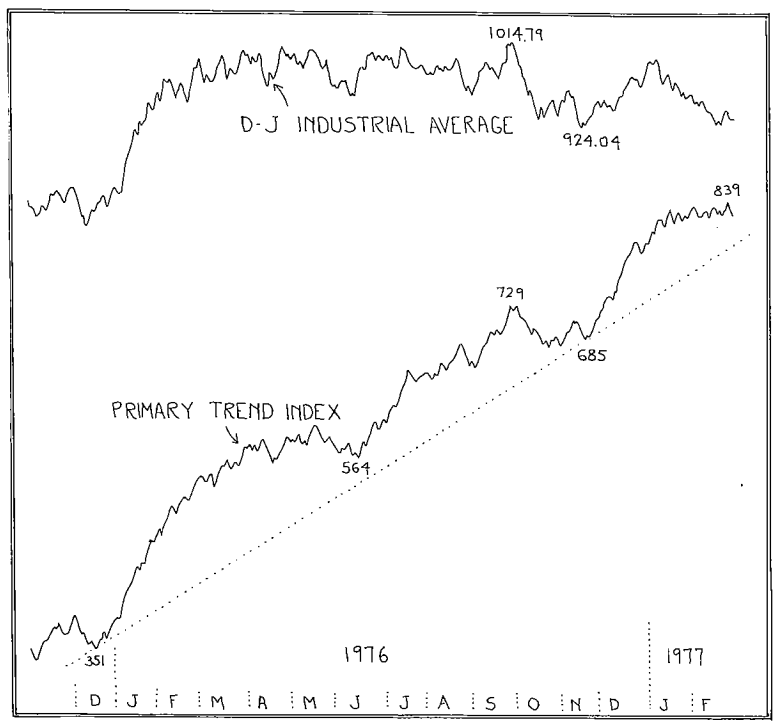


With the series of successively lower PTI peaks, something seemed to snap in the market. The PTI went into an all-out crash, an extraordinary collapse that carried through to the end of the year. Even the July-October rally in the Dow (to 987.06) went literally unnoticed by the PTI. Nothing could stop its sickening plunge. This PTI action proved to be the forerunner of the final 1974 cave-in on Wall Street.

Now turn to the current chart of the Dow and the PTI. Here the picture is just as extraordinary–but in **reverse**. From December, 1975 to February, 1976, the Dow and the PTI advanced together as if locked in gear. But after February the Dow moved sideways in a tight range bound by 1014.79 on the upside and 924.04 on the downside (actually, a range of about 9%). Yet during all the time the PTI worked steadily higher, propelled upward by a constant bullish majority in its eight component indicators and averages.

Conclusion: Looking at the 1972-73 performance, this is what we see. We see two years of action in which the PTI traced out a series of declining tops, this to be followed by a general market collapse. The continuing weakness in the PTI regardless of strength or weakness in the Dow, was telling us it was a primary bear market.

Looking at the late-1975-to-present action we see a series of rising bottoms and peaks on the PTI against a generally sideways performance by the Dow. Currently, the PTI is 145 points above its November low of 685, a low that corresponds with the November Dow low of 924.04. The entire 1975-77 performance is so infinitely different, so much stronger than that of 1972-73, that it is hard to believe that the PTI is saying anything other than "It's a primary bull market."

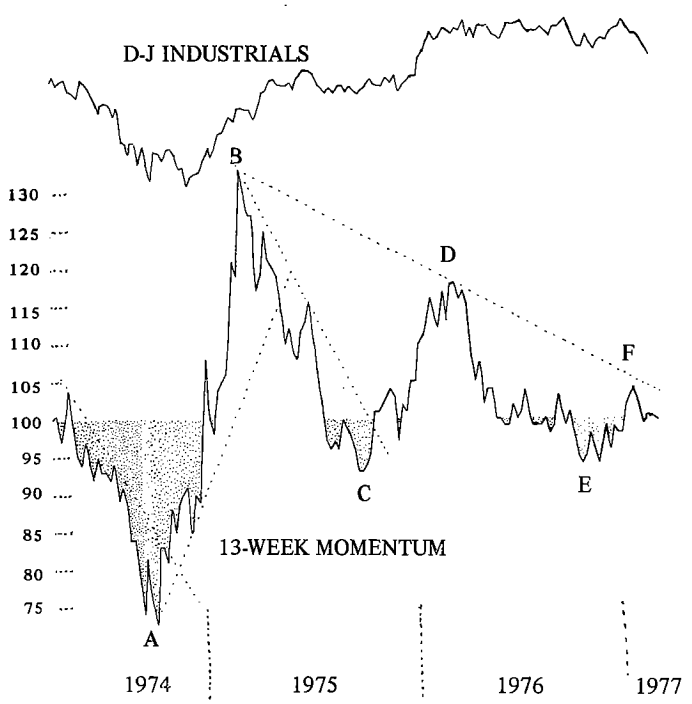


DOW MOMENTUM: We're at the point where the Dow momentum studies are worth talking about. The accompanying chart is what I term a "Dow Momentum" study although many analysts call this a "rate of change" chart. It is constructed by dividing the price of the Dow each Thursday (closing) by the comparable Dow price 13 weeks ago. When the ratio figures are below 100, it indicates that the current Dow price is below its price of 13 weeks ago, and these areas are shaded on the chart. Any ratio figure above 100 indicates that the current Dow is selling above its price of 13 weeks ago.

I have often stated that the market, like a rubber ball, is subject to the laws of physics, and that every action in the market is subject to an opposite and compensating reaction. The 1973-74 crash took the Dow momentum index down to an incredible 73 (point A on the chart). At that point the Dow was selling for 73% of its price 13-weeks previous. This period of extraordinary compression reached its climactic point at A in September, 1974.

Following the crash, the momentum index exploded to the upside, reaching a high point at B on the chart in February, 1975. That high registered 133 on the momentum index, meaning that the Dow in mid-February was 33% above its price of just 13 weeks previous!

Next came the compensating decline in the index to the September, 1975 low at point C on the chart. A new period of rising momentum followed, and this second surge took the index (point D) to a peak of 118. Here it was apparent that the rate



of change in the Dow swings was "calming down," moving slowly and steadily **towards equilibrium.**

All during 1976 the momentum index declined, reaching a low in December, 1976 of 94 (E on chart). Most recently, we had an upward blip (F) which took the index to 104. And now, now the momentum index has come back to rest at almost perfect equilibrium at 100, the point at which the Dow is selling for exactly its price of 13 weeks ago.

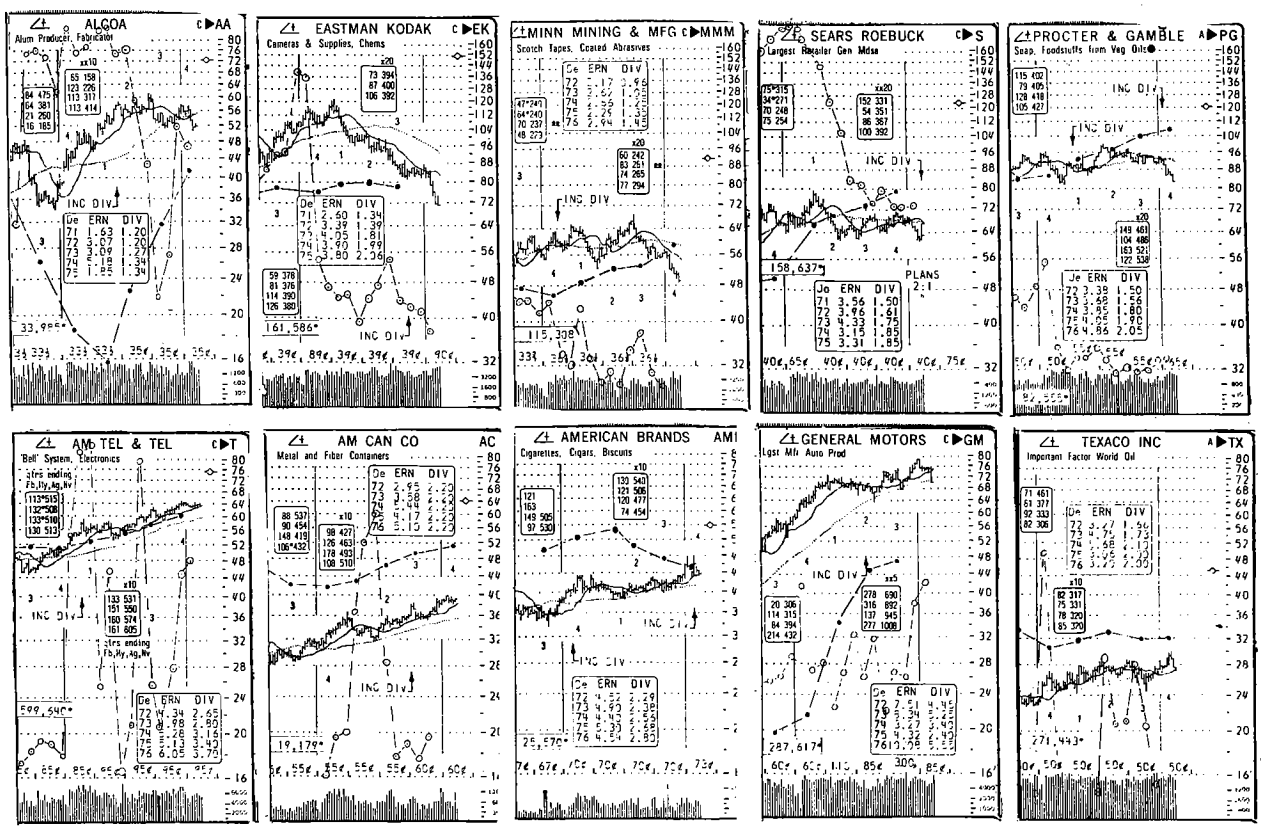
I have drawn a declining trendline connecting the 1975 and 1976 peaks in momentum. It is possible that the index will, on its next impulse, push above this trendline thereby starting a new upward cycle on both the Dow and the momentum index. It is also notable that since late-1974 no downside thrust of the momentum has taken the index lower than the 94 reading at point C.

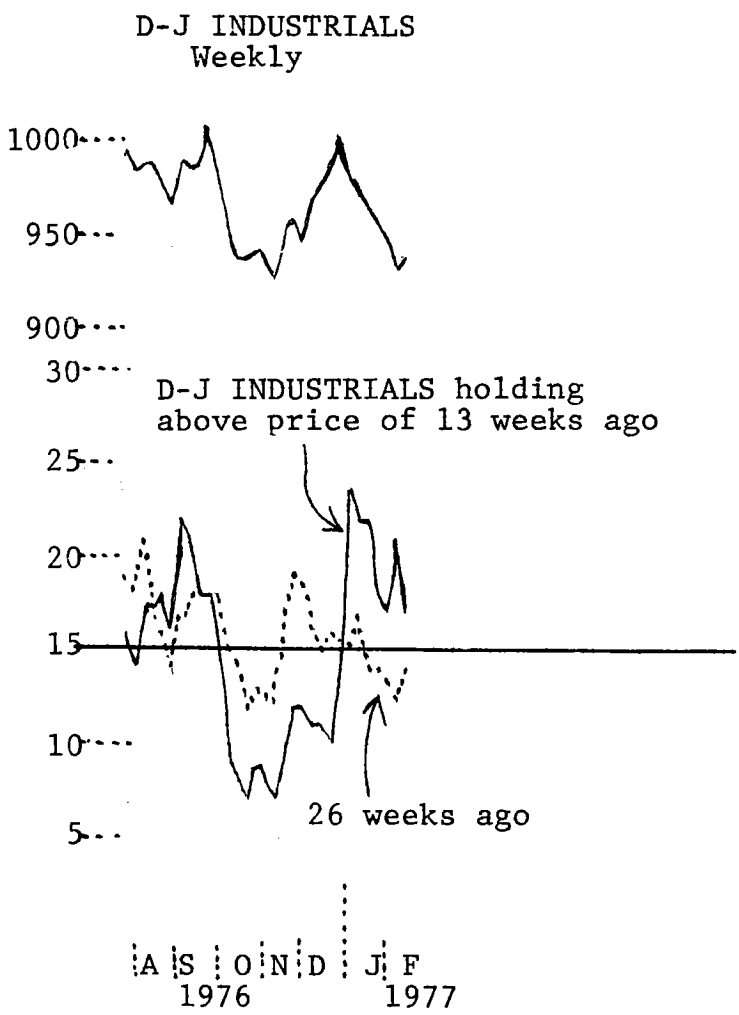
Last week, with the Dow sitting at 99 or just about on equilibrium, I decided that I wanted to study Dow momentum in more *detail.* Therefore, I decided to break Dow momentum down into what the 30 components of the Dow Industrial Average were doing. Following are the results.

ANALYSIS: The action of the past few months was in some ways most extraordinary, and in other ways very fundamental. I've been emphasizing value and return (yield) ever since this bull market started in late-1974. If you go back to my original stock recommendations in December, 1974 and January, 1975, you will note that the stocks that I thought were great values, once-in-a-lifetime values, were not the Dow stocks or the glamor-growth issues, but those better companies (many were household names) that had totally collapsed during the 1973-74 crash.

These included stocks like *Cluett Peabody* (then 2 3/4), *McGraw-Hill* (then 5½), *Bell & Howell* (then 9), *Coca Cola of NY* (then 1½), *Macy's* (then 11), *Reynolds Metals* (then 15), *General Cinema* (then 5), *Papercraft* (then 6½), *Melville Shoe* (then 5½), *National Distiller* (then 14), *Ogden* (then 15), and so forth. In other words, I have placed the emphasis on great value, bargain prices, buying stocks below known values, and suddenly, lo and behold the institutions have come to the same "shocking" realization.

I include 10 weekly charts on this page (courtesy of *Quote*, Box 213, Wichita KA 67201). The top row includes the five Dow stocks that were providing the **lowest yields** as of January 3, 1977. None of these stocks on that date yielded as much as 3%. The lower row contains the five Dow stocks with the highest yield as of January 3. The Average yield on the five was 6.5% as of that date.





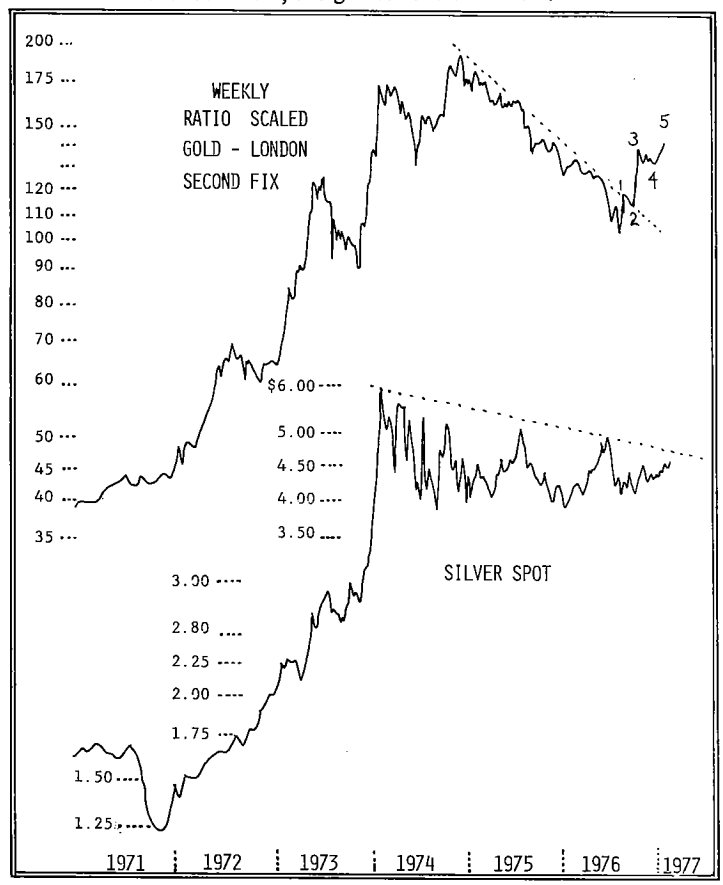
The striking thing about the two sets of Dow Industrial stocks is this: the low yielding, more glamorous top row have all come down substantially in price. But the bottom row of high-yielding Dow stocks have all tended to hold or resist during the decline in the Industrial Average.

As a matter of interest, I have not recommended any of the five low yielders at any time since this bull market began. But I did recommend purchase of four of the five high yielders. I recommended purchase of *Am. Can* and *Am. Brands* in the Letter of Feb. 14, 1975, I recommended *GM* in the Letter of Aug. 15, 1975, and I recommended *Am. Telephone* (the Convert.Pref.) in the Letter of May 21, 1976.

Now there is another fascinating puzzle connected with the 1977 market action, and I have illustrated it on the chart. What we see here is a breakdown of the 30 Dow Industrials in terms of the **number of Dow stocks holding** above their price of 13 weeks ago (the solid line on the chart), and the number of Dow stocks holding above their price level of 26 weeks ago (dotted line). The 13 week line is the more sensitive advance indicator, and any concerted move by the 13 week index will be followed in time by the 26 week indicator.

Note that during the decline that began in early January, 1977, a most amazing and deceptive situation existed. During the entire decline the majority (never less than 17 out of 30) of the Dow Industrial stocks were actually holding **above** their price of 13 weeks previous! What does that tell us? It tells us that the decline was deceptive and viciously ***selective***. It tells us that even while **Kodak** and **MMM** and **Proctor** and **Sears** were correcting, the majority of the 30 Dow stocks were holding stubbornly above their price 13 weeks previous.

Compare this action with the action during the October-November, 1976 decline. At that time the solid line plunged and at the bottom of the reaction only 7 Dow stocks were able to hold above their 13-weeks previous price. That decline was not selective, it was broad. The inference is that the 1977 market has been selective on the downside, not only in the entire list of all NYSE issues, but in the Dow stocks as well. This **selective downside action** is a technical plus. Where Wall Street is concerned, the more selective the weakness, the less the weakness. Conversely, the broader the weakness, the greater the weakness.



GOLD: In Letter 685 I first called attention to the gold price pattern and the application of the Elliott Wave Principle. The problem: was gold in a bull or a bear market? I stated at the time that bull movements assume the form of a 1-2-3-4-5 rising pattern with the 1-3-5 legs being advances and the 2 and 4 legs being corrections. At that time, gold had traced out a 1-2-3 formation, which could have been a bear market rally or it could have been an incompleted first stage of a bull market. The question was–would gold push out above its November 15, 1976 peak of 138.85, thereby adding the required leg-5 to the pattern? A move above 138.85 would (1) confirm the beginning of a gold bull market under Elliott, and (2) warrant initial purchases of gold and (where subscribers already owned gold) warrant additions to gold holdings.

How does one buy gold? Simple, the safest way is to own it via purchase of **Krugerrands**. Any reputable coin dealer or bank should be able to buy you all the Krugerrands you want. In addition, the Wall Street Journal carries ads for sellers of Krugerrands, as do many local newspapers. Gold coins (insured) can easily be shipped through the mails.

On today's (Feb. 23) afternoon fix in London, the deed was done. Gold recorded a price of 139.10, and according to my studies, we are now in a bull market in gold. I have marked the Elliott numbers on my weekly chart, and the current leg 5 is underway. It is characteristic of the 5 leg that it is the speculative leg, usually but not always.

Silver will probably follow gold. The long declining trendline which has held silver down since 1974 would be reversed decisively by a move to $5. I think that's going to occur.

The question immediately arises, can we have a bull market in stocks and in gold? My answer is yes, at least for a while. When you buy gold, you are speculating against the dollar. When you buy a stock, you are swapping your dollars for an equity. But the stock market thrives on stability, and a declining dollar represents instability. Therefore, the stock market will accept a **temporary** adjustment in the value of the dollar, but it will not take **steady** deterioration.

The rise in gold is the market's first ***official warning to Jimmy Carter***. I said in the last Letter, and I'll say it again: "Jimmy, you'd better reverse the deficit situation–and fast. If you don't you're going to end up wishing you never gave up the Governorship of Georgia. You're now king of the biggest collection of free-spenders, junk dealers, hardware salesmen, pork-barreler's and con-men that the world has ever seen. You'll either start cleaning it up or you'll drown in it–with all the rest of us!

LATE NOTES: The Averages appear to be taking a stand (as I hoped they would), not at the October-November lows, but at last week's (February 14) lows of **931.52** for Industrials, **223.74** for Transports (turn to the page 1 chart). On February 15 and 16 the Transports slipped below their 223.74 low, but for the first time in five months the **Industrials showed some strength**: they refused to confirm the Transports in that they held well above their own February 11 low of 931.52. Volume has declined sharply as the Averages tested last week's lows. A contraction of volume as the Averages approach the preceding lows implies an evaporation of selling pressure, and that's what I believe we are seeing now.

So on the short term picture, we now have a downside non-confirmation with Industrials looking reasonably strong (in that they did not follow Transports under the February 11 lows) for the first time in months. On a cold reading of the market, I would say that the structure has the appearance of a "buy spot." If I am correct, the 931.52 Industrial level should hold. Any decline below 931.52 would be discouraging.

The A-D Ratio is still only 1.17 points below its January 3 bull market peak, and I have never seen such a strange and frustrating (frustrating to me) performance on the part of the A-D Ratio. At this point I really cannot decide whether to call the buying stampede (which began on October 25) intact or terminated. Every time the A-D appears ready to plunge, it floats back, and therefore **I continue to give it every benefit of the doubt.** Any further real weakness from here (Feb. 23) would certainly serve to finish off the buying stampede. So let's see what happens (patience, Russell).

NEW BUSINESS: When I was in my teens, I was on my way to becoming a botanist. I loved plants, and my particular fascination was Cacti. I collected hundreds of specimens, built up a huge library of Cactus literature, and corresponded with the four Cactus nurseries that were situated in San Diego in the late-1930's (that is how I first heard about San Diego and its extraordinary weather). Since growing Cacti in a NYC apartment is tantamount to growing oranges in Alaska, I spent many years dreaming of moving to the West. Time passed, I got through WW II, I got through the 1940's and '50's.

Actually, if it had not been for my love of desert plants I am sure that I would never have moved West in 1960 (a life-long ambition). When I arrived here my first reaction was, "Where are the desert gardens, where are the Cacti?" There are around 5,000 species of Cacti native to the Americas, but I saw maybe ten in California (usually in tiny clay pots in Woolworth's). The fact is that there is far more interest in Cacti in Holland, Germany, England and Japan than there is in California.

Instead, what we have here are green lawns, miles and miles of lawns. It's as if the Easterners and Mid-Westerners who moved to California all decided to bring their environment with them. I never thought that would work, and now I'm certain that it isn't going to. The fact is that all of Southern California is naturally *semi-arid* or *arid* (desert). All of Arizona is desert. So is Nevada and most of the Western states. But here's what nobody talks about during the current horrendous drought–millions of gallons of water are used daily to keep the grass green in the West. In an attempt to keep California looking like Connecticut, Westerners are living out a weird and vanishing dream.

I have always felt that Californians should go in for desert planting, planting of Cacti and succulents which will require little or no water. And as the price of water rises out here, as the water becomes increasingly scarce, I predict that the whole system of landscaping will change. Desert planting (as they should) will become the dominant look of Southern California.

If I were a young man in Southern California, and I was looking for a business to go into, I would think seriously about desert landscaping. It's got to be the wave of the future in this area. And it *hasn't started yet*. I don't think there's a really good desert planting within 50 miles of San Diego. The average gardener doesn't know a Cactus from an Agave or a Yucca. But that will change. The tide is set in the West. The day of the big green lawn that is kept alive all through the hot summer with cheap water is coming to an end. The day of the xerophyte (desert plant) is finally upon us.

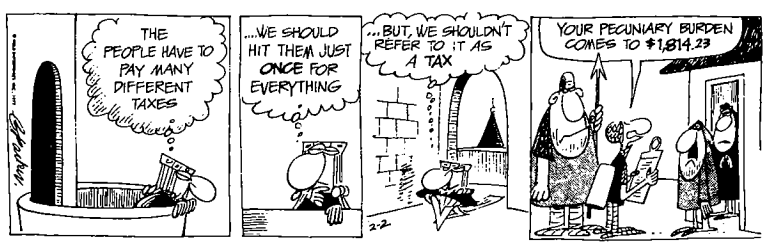
ITEMS: On the tail of last week's "Crossroads" piece comes this news item from Jolly England. This is what happens as the government takes over the means of wealth and the people are left with the "stores of value." Ultimately, they are forced to sell their valuables just to stay alive. Did Franklin Roosevelt know something when he brought in the New Deal while building one of the world's great stamp collections?

In Letter 686 I wrote about the swing in America towards an older population. The pendulum of power is moving now towards the elderly (in population and voting figures), rather than youth. This week *Newsweek* (Feb.28) puts it on the cover.

LONDON — Lady Spencer-Churchill is selling six of her most cherished paintings, including two by her late husband, Sir Winston Churchill, and a portrait of herself and her daughter, Sarah, in an effort to make ends meet. During the past few months, she also has sold furniture and silver.

Her only government income is $26 per week, similar to Social Security, that the British Treasury pays all single pensioners. And while the still active, 91-year-old widow of the wartime prime minister has other resources, she, like the rest of the British well-to do, has been affected far more by inflation, taxation and a soft stock market than working-class Britons.

Sigmund Freud believed that laughter is basically the organism's release of tension, an explosion of that which is repressed. The Wizard of Id seems to be on the right track, as far as releasing repressed fears is concerned. In this strip he's turned our fears regarding the income tax into a joke. I take my hat off to anyone who can do that.


THE WIZARD OF ID
By BRANT PARKER AND JOHNNY HART
THE PEOPLE HAVE TO PAY MANY DIFFERENT TAXES
...WE SHOULD HIT THEM JUST ONCE FOR EVERYTHING
...BUT, WE SHOULDN'T REFER TO IT AS A TAX
YOUR PECUNIARY BURDEN COMES TO $1,814.23

NEXT MAILING: March 9th.